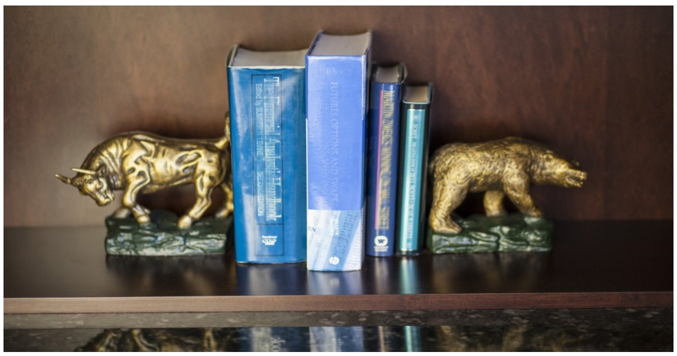
QUARTERLY NEWSLETTER

2019: FOURTH QUARTER 124[TH] EDITION



"The stock market is a device for transferring money from the impatient to the patient."
~Warren Buffett

TABLE OF CONTENTS

CAPITAL MARKETS SCOREBOARD 2

EQUITIES 3

FIXED INCOME 5

ECONOMICS 6

WALLINGTON PERSPECTIVE 7
A Look Back and Forward

8900 Keystone Crossing, Suite 1015, Indianapolis, IN 46240 www.wallingtonasset.com

CAPITAL MARKETS SCOREBOARD

Equities					
Indices	4Q19 Total Return (%)	2019 Total Return (%)	Index Characteristics		
Domestic			NTM P/E	P/B	Div. Yld. (%)
S&P 500	9.1	31.5	18.2	3.6	1.7
DJIA	6.7	25.3	16.9	4.1	2.1
NASDAQ	12.5	36.7	24.6	4.7	1.0
Russell 1000 Growth	10.6	36.4	23.0	8.5	1.1
Russell 1000 Value	7.4	26.5	15.2	2.1	2.4
Russell 2000	9.9	25.5	23.4	2.2	1.3
International*					
MSCI EAFE	8.2	22.7	14.8	1.7	3.0
MSCI Emerging Markets	11.9	18.9	12.9	1.8	2.2
MSCI United Kingdom	10.0	21.1	13.5	1.7	3.9
MSCI France	8.6	27.0	14.9	1.8	3.0
MSCI Germany	9.9	21.7	14.1	1.6	2.8
MSCI Japan	7.7	20.1	14.6	1.4	2.3

Fixed Income		
Indices**	4Q19 Total Return (%)	2019 Total Return (%)
Domestic		
U.S. Corp - Gov (1-3 Years)	0.6	4.1
U.S. Corp - Gov (3-5 Years)	0.4	6.6
U.S. Corp - Gov (10+ Years)	-1.3	18.8
U.S. Treasuries Master	-0.9	7.0
U.S. Corporates Master	1.1	14.2
U.S. Municipals Master	0.6	7.7
U.S. High Yield Master	2.6	14.4
International*		
Developed Markets Sov Bond	-0.6	5.5

Commodities		
Resource	4Q19 Total Return (%)	2019 Total Return (%)
Precious Metals		
Gold	3.7	18.9
Silver	4.6	16.7
Industrial Metals		
Copper	8.9	6.3
Aluminum	5.7	-3.7
Energy		
Brent Crude Oil	8.3	30.6
WTI Crude Oil	13.0	35.3
Natural Gas	-6.1	-25.5

Key Rates				
Rates	12/31/2019	9/30/2019	6/30/2019	12/31/2018
U.S. Target Fed Funds Rate	1.75	2.00	2.50	2.50
2-Year U.S. Treasury	1.58	1.63	1.75	2.48
10-Year U.S. Treasury	1.92	1.68	2.00	2.69
30-Year U.S. Treasury	2.39	2.12	2.52	3.02
10-Year German Bund	-0.19	-0.58	-0.31	0.24
10-Year Japanese Bond	-0.02	-0.23	-0.16	-0.01
30-Year Fixed Mortgage	3.72	3.61	3.80	4.64

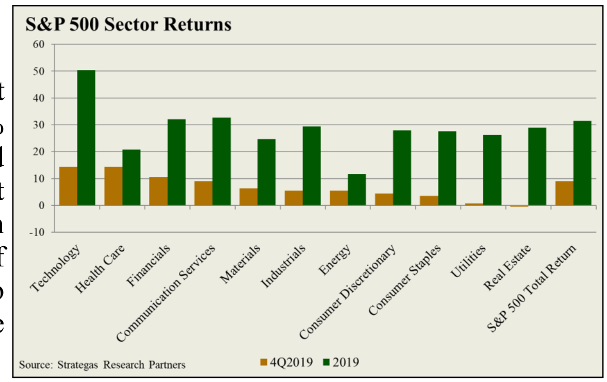
Currencies				
Indices/ Exchange Rates	12/31/2019	9/30/2019	6/30/2019	12/31/2018
ICE U.S. Dollar Index	96.39	99.38	96.13	96.17
USD per EUR	1.12	1.09	1.14	1.14
USD per GBP	1.32	1.23	1.27	1.27
JPY per USD	108.68	108.08	107.74	109.72
CAD per USD	1.30	1.32	1.31	1.37

*Returns denominated in U.S. dollars

**ICE Bank of America Merrill Lynch (BofA-ML) indices

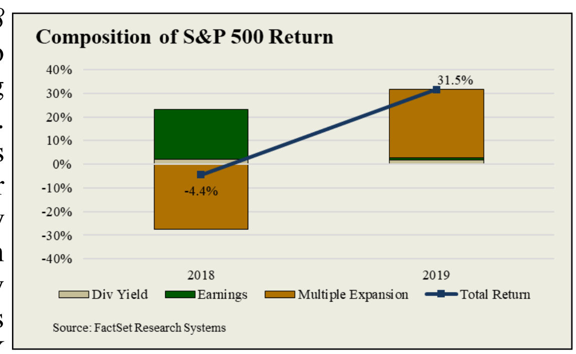
EQUITIES

- All major U.S. stock indices provided strong positive returns in 2019. The Standard & Poor's 500 (S&P 500) index posted a total return (price appreciation plus dividends) of 31.5%, its largest annual gain since 2013, while the Dow Jones Industrial Average (DJIA) gained 25.3% and the NASDAQ Composite Index (NASDAQ) was up 36.7%. Volatility also remained subdued throughout the year as exhibited by the S&P 500 never incurring a correction of 10% or greater. The fourth quarter provided particularly strong results with the S&P 500, DJIA, and NASDAQ gaining 9.1%, 6.7%, and 12.5% respectively. Although international equity markets generally trailed the U.S. in 2019, they were able to post significant positive returns as well. The MSCI Europe, Australasia, and Far East (EAFE) Index and the MSCI Emerging Markets Index were up 22.7% and 18.9% for the year when priced in U.S. dollars.



- All eleven sectors of the S&P 500 posted double-digit total returns for 2019. Leading the way with a 50.3% return was the Information Technology Sector followed by Communication Services at 32.7% and Financials at 32.1%. Energy Sector stocks provided the lowest return at 11.8%. Market breadth, as indicated by the number of stocks advancing versus declining, continued to improve throughout the year with over two-thirds of the stocks showing advances at year end.

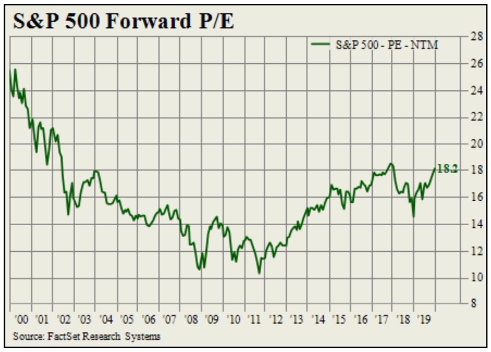
- Microsoft and Apple have continued their market leadership with both companies achieving market capitalizations of over $1 trillion each. Their combined market values now exceed the entire market capitalization of the Russell 2000, an index of roughly 2,000 small-cap companies in the U.S. The largest five stocks in terms of market capitalization (Apple, Microsoft, Alphabet (Google), Facebook, and Amazon) contributed over one-fourth of the S&P 500 price point gain in 2019. In terms of dollars, the S&P 500 gained nearly $6 trillion in market capitalization in 2019, and these five stocks gained over $1.5 trillion in value. While it is common for the largest stocks to contribute significant percentages of the S&P 500 point gain in any given year, it is notable that of the top five stocks listed above, only Microsoft was among the top five at the beginning of the decade along with General Electric, Cisco, Walmart, and Intel.



- Earnings growth for the S&P 500 was significant in *2018* with earnings per share (EPS) climbing nearly 21% to $161.45 from the previous year. Despite this strong growth, the S&P 500 provided a -4.4% return in 2018. Although stock performance rebounded, EPS growth is forecast to be markedly lower in *2019* with full-year estimates for a less than 1% increase to approximately $162.35 per share. Aggregate slower earnings growth in 2019 was primarily driven by expectations for the Energy Sector to report a -27.8% year-over-year (Y/Y) earnings decline and the Materials Sector to report a -16.0% Y/Y decline. The Industrials, Consumer Discretionary, and Information Technology Sectors are expected to report Y/Y decreases as well.

EQUITIES

- With the lack of earnings support, the multiple investors were willing to pay for earnings (P/E ratio) provided most of the market returns in 2019. The forward P/E ratio on the market increased dramatically in 2019 to 18.2x from 14.6x next twelve months earnings to start the year. The current P/E, though near a post-recessionary high, trades only mildly higher than fair value when considering the Rule of 20, introduced in 1999 by Professor Glenn Tanner. Tanner posited that a fair value P/E for the stock market should be 20 less the rate of inflation. Accordingly, with inflation around 2.1%, Tanner's model would suggest a fair P/E for the market would be 17.9. Another similar indicator suggests the P/E multiple of the stock market should be in the range of 18 less the rate of inflation on the low end and 22 less the rate of inflation on the high end. It is important for investors to keep in mind valuation measures are not reliable indicators for the near to intermediate-term direction of the stock market. Instead, they provide a means for investors to measure the price risk they are assuming when investing capital. Ultimately, lower interest rates help justify higher stock market valuations, as the opportunity cost of not allocating capital to fixed income instruments is lower.

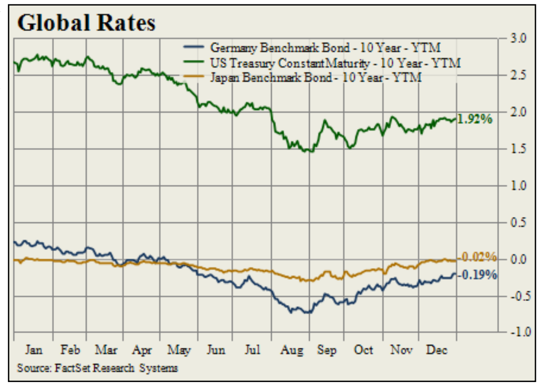


- The number of initial public offerings (IPOs) in 2019 came in at a respectable count of 160, raising $46.3 billion. This number is down from last year's 192 offerings which raised $46.9 billion. In terms of numbers of IPOs, the 20-year average has been closer to 163. Renaissance Capital had initially identified 220 companies that could have gone public in 2019. According to Renaissance, the average IPO gained 20% in 2019. This was a dramatic improvement over last year's average of -16.7%. Most of the returns from 2019's IPOs came in the first day of trading. The average first-day return of 18.2% was the best since 2013. After the end of trading on the first trading day, IPOs generated on average a paltry 1.1% return. Clearly earnings mattered, however, as Uber, losing an estimated $2.95 per share, priced its IPO at $45.00, opened trading at $42.00, and ended the year priced at $29.74. Lyft, losing $6.66 per share, priced its IPO at $72.00 per share and closed the year trading at $43.02. Peloton, losing $9.17 per share, priced its IPO at $29.00 and closed the year at $28.40.

Source: Renaissance Capital

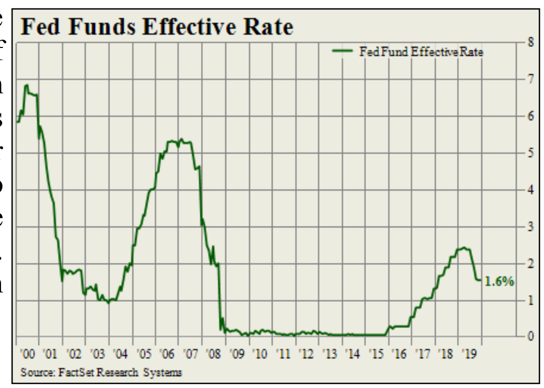
FIXED INCOME

- The U.S. yield curve (the spectrum of U.S. Treasury (UST) yields across varying maturities) steepened notably in the fourth quarter. This was caused by both an increase in yields for USTs with three to thirty years to maturity, and a decrease in UST yields for securities with two years to maturity and under. After beginning the quarter at 1.68%, the 10-year UST yield ended the year at 1.92%. This was still far below the 10-year UST yield at the beginning of the year of 2.69%. These movements caused U.S. corporate and government bonds with over 10 years until maturity to lose 1.3% for the quarter but still gain 18.8% for 2019, as measured by BofA-ML indices. Less interest rate-sensitive short-term corporate and government bonds with one to three years until maturity gained 0.6% for the quarter and 6.6% for the year.



- Credit spreads, the yield differential between corporate and government debt, tightened over the quarter, causing corporate bonds to broadly outperform. While USTs in aggregate lost 0.9% for the quarter and gained 7.0% for the year, U.S. corporate bonds outperformed and gained 1.1% during the fourth quarter. This brought their 2019 gain to 14.2%. U.S. high-yield ("junk") bonds added even more value amidst a relatively stable equity and economic backdrop and added 2.6% during the final three months of the year. The year-to-date gain of 14.4% for high-yield bonds in 2019 was notable given increasing default rates. According to Fitch Ratings, the default rate is expected to increase from 2.4% in 2018 to 3.5% in 2020.

- The Federal Reserve (Fed) opted to hold the fed funds rate in a range of 1.5% to 1.75% in December, ending a series of three rate cuts. These cuts followed nine rate increases from December 2015 through December 2018. The Fed appears to be inclined to keep the fed funds rate stable for the near future. Fed Chair Jerome Powell noted they would need to observe significant economic deterioration to cut the rate further, or increased and persistent inflation to raise the rate. As of year end, the forward rate market was pricing in an around 60% chance of one additional cut in 2020.



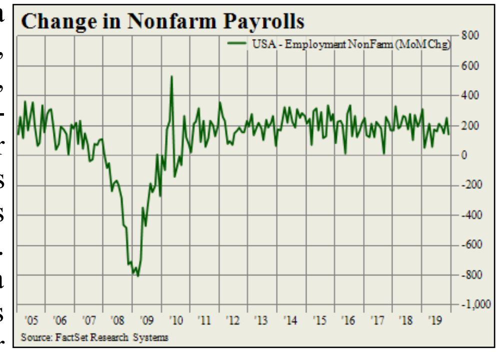
- Global interest rates increased broadly along with U.S. rates. The 10-year German bund yield increased from -0.58% to start the quarter to -0.19%. This was still markedly lower than its 0.24% rate to start the year. The Japanese 10-year bond accomplished a round trip, beginning the year yielding -0.01% before dropping to a 2019 low of -0.28% in the third quarter. Rates then rallied through the fourth quarter and the bond finished the year yielding -0.02%. These movements drove the amount of global negative-yielding debt to below $11.3 trillion to close the year, after peaking at over $17 trillion in August.

- Despite low and negative rates globally, foreign ownership of USTs has fallen in recent years. After peaking above 43% in 2008, foreign ownership has decreased to around 36% of total debt outstanding. This is due to a multitude of factors, including increased issuance of USTs to fund the growing U.S. deficit. While the relative percentage of USTs held by foreign entities has decreased, the absolute level has continued to increase. Another key factor has been emerging market central banks liquidating their USD reserves to manage their currency against a strong dollar. China has reduced its UST ownership by over $30 billion for the year ending in October, although their total reserves remain over $1.1 trillion.

ECONOMICS

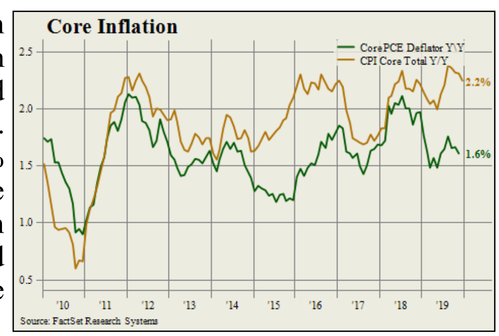
- The third and final estimate of third-quarter real gross domestic product (GDP) growth was a 2.1% seasonally-adjusted annualized rate (SAAR). Consumer spending grew 3.2% in the quarter, accounting for most of the GDP growth. Government spending was also a contributing factor while business investment and net exports were negative contributors. GDP growth estimates for the fourth quarter are ranging around a 1.5-2.0% SAAR, backed by strong consumer spending and retail sales. Jobs and wage growth have kept consumer confidence close to historical highs.

- There were 145,000 jobs added in December, down from 245,000 in November. In 2019, 2.11 million jobs were created, the smallest annual increase since 2011. This should be expected given the 3.5% unemployment rate, 120 consecutive months of job gains, and a slowing U.S. and global economy. For the first time since 2010, there were 109,000 more women than men on nonfarm payrolls, although this does not count agricultural workers or the self-employed which favor men. Service-sector jobs, which favor women, increased 1.5% in 2019 while goods-producing jobs increased 0.8%. Pay raises have come in below expectations given the low unemployment rate and 10 years of job growth. Average hourly earnings increased 2.9% in December from a year earlier, down from a 3.4% Y/Y increase in February. Raises for nonsupervisory and low-wage workers are increasing faster than for supervisory staff and high-wage earners. The labor market remains tight as job openings of 7.27 million still exceed the 5.86 million unemployed people in the labor force.



- Existing home sales increased 2.7% in November from a year earlier, the fifth consecutive month of Y/Y gains. New home sales are also doing well. Single-family housing starts increased at an annual rate of 916,000 in November, the highest since 2007. The NAHB Housing Market Index which serves as a proxy for builders' confidence is at its highest level since 1999. There was a 3.7-month supply of homes on the market at the end of November relative to the current sales pace. Limited housing stock has contributed to higher home prices; the median sales price of $271,300 for an existing home was up 5.4% in November from a year earlier. Investors are buying 20% of lower-priced homes to rent out, further limiting supply. Baby boomers are expected to supply 21 million homes to the market by 2037, which should help alleviate the inventory problem.

- Inflation has remained constrained. The Personal Consumption Expenditures Price Index (PCEPI) increased 1.5% Y/Y in November and Core PCEPI (which excludes volatile food and energy prices), the Fed's preferred measure, rose 1.6% Y/Y. Meanwhile, the overall Consumer Price Index (CPI) rose 2.1% Y/Y in November and Core CPI increased 2.3% Y/Y. Only the Fed's preferred core PCEPI is under their 2% inflation target. In addition to CPI, inflation measures by the Atlanta, Dallas, and Cleveland Federal Reserve Banks show inflation running above 2%.



- Congress passed the U.S.-Mexico-Canada Agreement (USMCA) which updates the 1994 North American Free Trade Agreement (NAFTA). The administration also agreed to a limited "Phase 1" trade agreement with China which rolls back some tariffs and suspends new ones in exchange for China's promise to purchase billions more in agricultural products. It does not address some bigger issues such as support for state-owned enterprises. The trade deficit fell 8.2% in November from October to a seasonally-adjusted $43.1 billion. This was the lowest level since October 2016. Exports increased 0.7% and imports fell 1.0% for the month. The trade deficit had fallen 0.7% in the first 11 months of 2019 and is on pace to decline for the first calendar year since 2013. Most of the improvement is the result of a smaller trade deficit with China; for the 12 months ending in November, the goods trade deficit with China has declined by $55.9 billion. Mexico and Canada have replaced China as our biggest trading partners.

A Look Back and Forward

What a difference a year makes. At the end of 2018, the Fed had just raised interest rates for the fourth time that year and was forecasting three more increases in 2019. Stocks were plummeting and trade tensions rising. At the end of 2019, things were not nearly as bad, even somewhat normal. The economy in 2019 reverted to the "new normal," the 2% GDP growth rate of prior years. The year started out with first-quarter annualized GDP growth of 3.1% but fell to 2.0% in the second quarter and 2.1% for the third quarter. If GDP growth is close to 2.0% in the fourth quarter when it is finally reported, growth for 2019 will come in around 2.3%, down from 2.9% in 2018.

The economy faced several crosswinds in 2019. Trade tensions were one of the biggest headwinds throughout the year. Even though a "Phase 1" trade agreement with China was reached in December, trade tensions are expected to continue not only with China, but also Europe and Latin America. Trade tensions and policy uncertainties are the primary reasons CEO confidence in 2019 was at its lowest level in a decade. This corporate gloom resulted in negative business investment in the second and third quarters of the year. Other CEO concerns that permeated 2019 were slower synchronized global growth and a manufacturing recession in most developed countries plus China. In the U.S., manufacturing has contracted for six consecutive months. While manufacturing no longer plays as prominent a role in today's economy as it contributes only 11% of GDP and 8.5% of employment, it is still considered an economic bellwether.

The biggest tailwind for the economy in 2019 was the state of the consumer. Unlike CEOs, consumer confidence has been at favorably higher levels. While the Consumer Confidence Index pulled back slightly in December from November, the present-situations index continued to move to new cycle highs and reached its highest level since June 2001. Unemployment of 3.5% represents a 50-year low, wages have been growing at a 3% annual rate, and jobs have remained plentiful. Household balance sheets are in good shape and household net worth (assets minus liabilities) closed 2019 at an all-time high. The consumer was certainly a pillar of strength for the U.S. economy in 2019.

Other tailwinds last year included monetary and fiscal policy. After raising interest rates four times in 2018, the Fed did an about-face and cut rates three times in 2019. These were "insurance cuts" because of trade tensions, slowing global growth, and the manufacturing recession. Even though the unemployment rate is at a historic low, inflation has been moderate as the Fed's preferred measure of inflation continued to meander below its 2% target in 2019. Monetary easing and subdued inflation were primarily responsible for the 10-year U.S. Treasury bond yield falling from 2.69% at the beginning of 2019 to 1.92% at year end. This has been good for consumers, homeowners, and corporate borrowers but has also created financial repression for savers. The biggest benefactor of lower interest rates has been the U.S. government. As the effects of the 2018 tax cuts waned, the government attempted to stimulate the economy via spending and fiscal deficits. The deficit surpassed $1 trillion for the 12 months ending in October 2019 for the first time since the Great Recession. These $1 trillion fiscal deficits are projected into the foreseeable future.

Recessions tend to catch economists unaware, and the ones they do see coming often do not happen. In 2018, many economic pundits were predicting a U.S. economic recession in 2020. But recession fears have been dialed back. One of the red flags of 2019 was an inverted yield curve – short-term interest rates higher than long-term rates. As the year closed, though, it was no longer inverted and back to a more normal state. The other red flag was manufacturing. While still contracting, it has been doing so at a decelerating rate and stabilizing. As 2019 closed, the outlook for the global economy was improving; the economies of the U.S., China, and Japan had improved, although this was not the case for the Eurozone.

The stock and bond markets reacted favorably to the economic crosswinds in 2019. The price of the S&P 500 appreciated 28.9% in 2019. To keep this in perspective, some of the 2019 stock market appreciation was in reaction to the dismal performance in the fourth quarter of 2018; the S&P 500 peaked at 2,930.75 in September and fell to 2,351.10 to close Christmas Eve day, a decline of 19.8%, excluding dividends. A decline of 20% would have been classified as a bear market and would have marked the first since 2007-2009. Since earnings growth was mild in 2019, the stock market's appreciation was almost all due to higher valuation metrics. Given the stock market performance, individual investors do not seem to be enthused about the longest-running bull market in history. In 2019, investors have withdrawn more than $156 billion from equity mutual funds and exchange-traded funds – the largest withdrawals since tracking of fund flows began in 1992. There were record inflows into money market and bond funds in 2019. Going back 35 years, 2019 was the first time the S&P 500, crude oil, and gold all appreciated at least 10%. Gold had its best year since 2010 and the S&P 500 since 2013. As both short-term and long-term interest rates fell in 2019, bond markets also performed well – the longer the maturity, the higher the interest rate risk (sensitivity), the better the performance. It certainly paid to follow the Wall Street adage "Don't Fight the Fed" in 2019.

In the U.S., 2020 economic growth hangs on the consumer, as consumption is more than two-thirds of overall GDP. The household sector is in good shape. While debt was at an all-time high of $13.95 trillion at the end of the third quarter of 2019, it represented 73% of GDP versus 83% in 2009. Household net worth was $114.9 trillion at the end of the second quarter of 2019, a record high, and debt payments as a percentage of disposable personal income were 9.7% versus 13.2% in 2007. Shoppers have been the heroes of this record-setting economic expansion, 10.5 years and counting. Consumer spending will continue to be the primary force driving the U.S. economy in 2020 given the strength of the job market, wage increases, and moderate inflation. Corporate investment is usually one of the driving forces in the later part of economic expansions and it was missing in 2019. It would help if corporate investment could get back on track in 2020 to alleviate some of the burden on the consumer.

Monetary and fiscal policy will continue to be economic stimulants in 2020. But headwinds still exist; trade tensions with China and the rest of the world will not abate, and election worries will probably trump everything. There are wide differences among potential presidential candidates, and the primary process and election may affect consumer confidence and already-deflated CEO confidence. Less trade and policy uncertainty would help the latter.

One macro factor to watch carefully in 2020 is inflation. Many believe inflation is permanently muted because of globalization, demographics, and price transparency at the consumer level. Thus far, the historical relationship between a record-low unemployment rate and inflation has not held up. If wage inflation picks up and the U.S. dollar weakens, overall inflation could perk up. If this happens, the Fed will be slow to counteract it by raising interest rates because it has adopted an asymmetrical inflation policy whereby its inflation target will be an average of 2%. Since the inflation rate has consistently been below 2%, the Fed plans to let it run above 2% for some time before tightening monetary policy. Higher inflation would translate quickly into higher interest rates which would certainly not be good for the bond and stock markets.

The consensus for U.S. economic growth in 2020 is the "new normal" of 2%. GDP is a function of the number of hours worked times output per worker (productivity). The number of hours worked has been increasing about 0.8% annually and productivity has also been increasing about 1.3% although it was negative in the third quarter of 2019. Given the low unemployment rate, the growth in the number of hours worked is expected to fall below 0.5% going forward. That leaves the heavy lifting to productivity which has been trending down for several decades; 2.8% annually in the 2000s and 1.3% since 2010. It will take a dramatic increase in productivity to get GDP growth out of its 2% rut. This is both a global and a domestic problem.

Investors would be wise not to expect a repeat of 2019's stock market performance in the coming year. In 2018, S&P 500 earnings increased more than 22% but the S&P 500 fell due to the volatile fourth quarter. In 2019, S&P earnings growth was muted but the S&P 500 increased substantially due to price-to-earnings multiple expansion, leaving valuations above historical averages. This could be justified based upon lower-for-longer interest rates. Interest rates will be a critical factor in how stock markets perform in 2020. Another factor may be "FOMO," fear of missing out. There are record amounts of money in money market and bond funds that could navigate into stocks. With bond yields at extraordinarily low levels, there are few alternatives to stocks, often referred to "TINA," there is no alternative. Real (inflation-adjusted) yields on bonds are barely above zero and stocks offer both the possibility of capital appreciation and dividend growth. Stock buybacks also offer some support for stock prices. S&P 500 earnings are expected to increase in 2020 relative to 2019 adding more support for the stock market. The consensus of stock market prognosticators is for market returns of around 5% in 2020 with 1.8% coming from dividends. Of note, similar returns were expected for 2019 when the year began. Also of note, election years have historically been good for the stock market with only two down years since 1948. While there was evidence of some excessive positive sentiment amongst investors as 2019 closed, this bull market still remains one of the most hated bull markets in history. With the S&P 500 at a record level following the strong performance of last year, some prognosticators believe that stock prices have to fall. If history is any guide, 1937 is the only year in which the stock market declined more than 20% in the year following an advance of more than 20%. Stock prices will fall meaningfully at some point in time, as they always do. For investors, the question will be from what level the decline occurs and how long it lasts. Some of the forecasters, who near the end of 2018 were proven right with the steep decline into December, are still sitting on the sideline waiting for the ensuing bear market to prevail. Peter Lynch, the legendary manager of the Fidelity Magellan Fund, once said, "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." We agree but also strongly believe that investors, particularly individual investors, need to be certain their portfolios are structured in a manner which will allow them to consistently weather market declines when they arrive and truly understand the time horizon for the funds in their portfolio. Potentially as important today is not only how much exposure investors have to the stock market but also how they achieve that exposure. We would venture to say that many investors really do not understand their risk exposure, which contradicts one of the key principles we have employed at Wallington since the inception of the firm.